RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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March 25, 1981 **LETTER 805**

Mar. 13, DJIA 985.77; PTI 1422; A-D Ratio –17.39
Mar. 20, DJIA 992.80; PTI 1439; A-D Ratio –16.43

THE PICTURE: One of the oldest truisms on Wall Street is "News known is news discounted." So the question the market student most always ask is, "My studies show me so and so – BUT has the market already discounted this information?" In my own experience in over 25 years of market and economic research, I have found that 4 out of 5 times anything I know is already known, digested and fully discounted by the market. In fact I would say that the commonest mistake made by neophytes is thinking that the "inside information" they have in their possession – is not already known by the market. The neophyte trades on his supposed inside information – and loses his shirt.

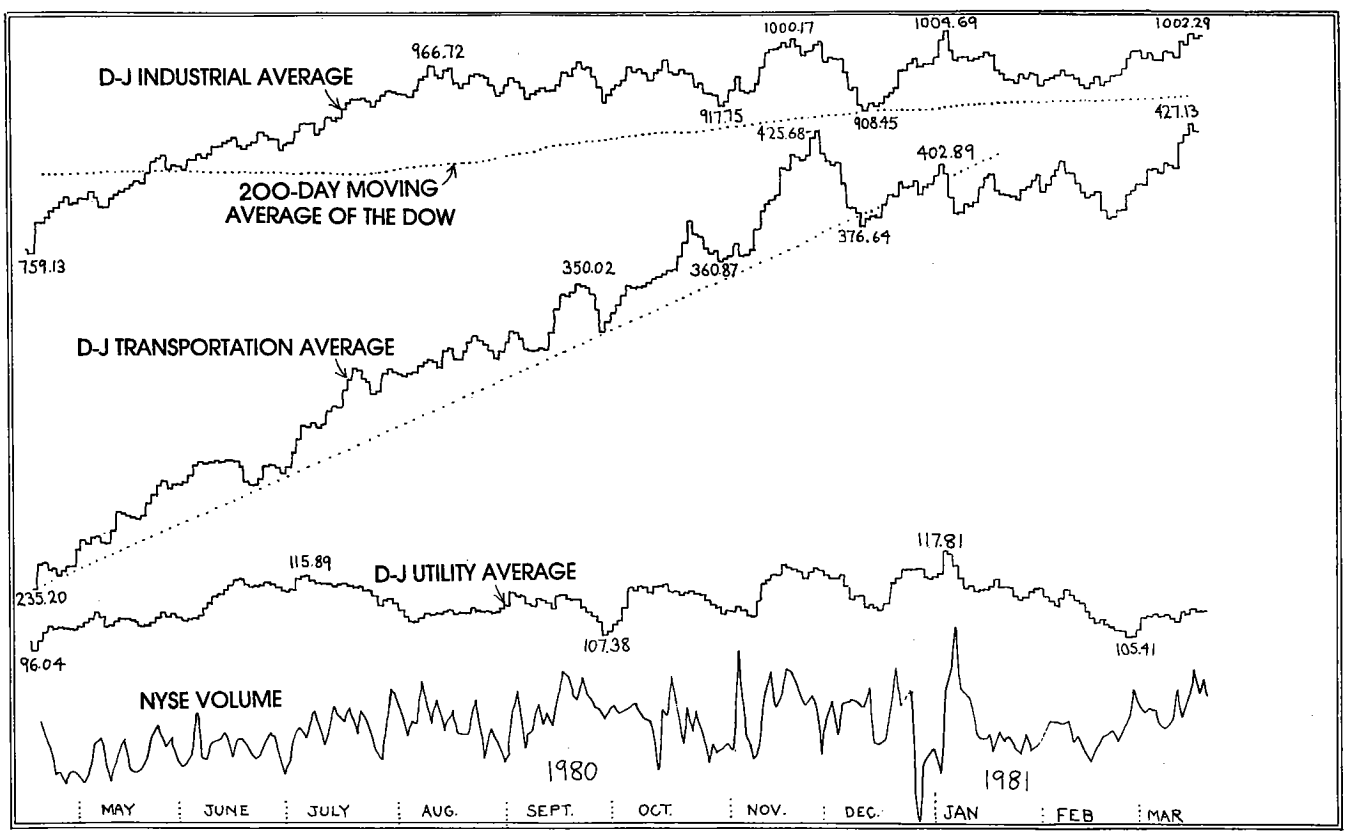
I have done a lot of work on Federal spending and the Federal budget. This is a most difficult subject, information is not easy to come by, and much of the available information is either incorrect or incomplete. In another part of this Letter I include a piece on Federal "off budget" financing, a liitle-known but critically important part of the budget puzzle. I think the off–budget financing could be the fooler, the surprise that provides the fireworks for 1981 (there I go with my own brand of inside information).

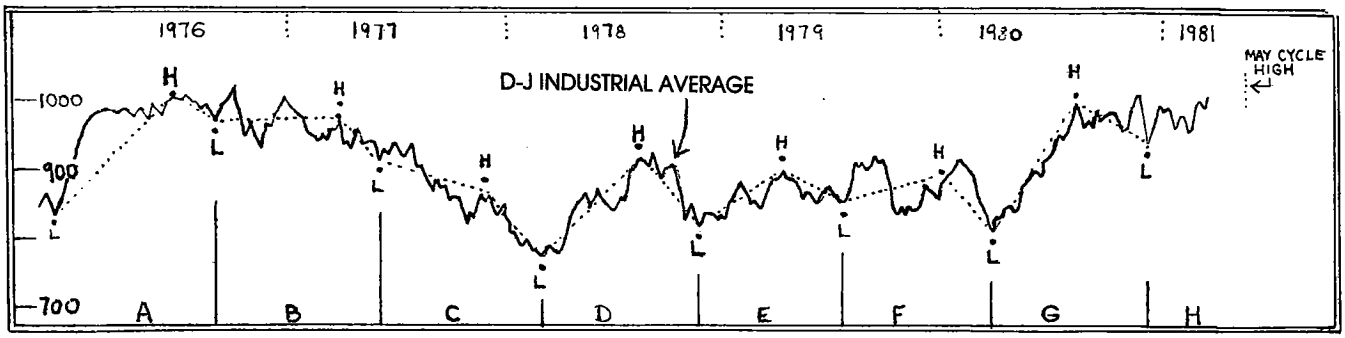
THE MARKET: The hardest thing to do in investing is to take a cold, unemotional view of the market; and, of course, this is doubly difficult when excitement reigns on Wall Street (as now). This may sound surprising, but since November 20, 1980, the market (from a Dow Theory standpoint) has said, "No verdict yet."

Study the chart below of the D-J Averages. You'll note that on Nov. 20 the Industrials recorded a high of 1000.17. On the same day Transports hit a high of 414.43. That was the last confirmed high in the Averages. At no time since have *both* Averages been higher. True, Transports on November 28 hit a record high of 425.68 but on that day Industrials were 993.34. Then on January 6, 1981 Industrials recorded a recovery high of 1004.69 – but on that day Transports closed at 402.89. Thus, the high for the advance (so far) was recorded on November 20, 1980.

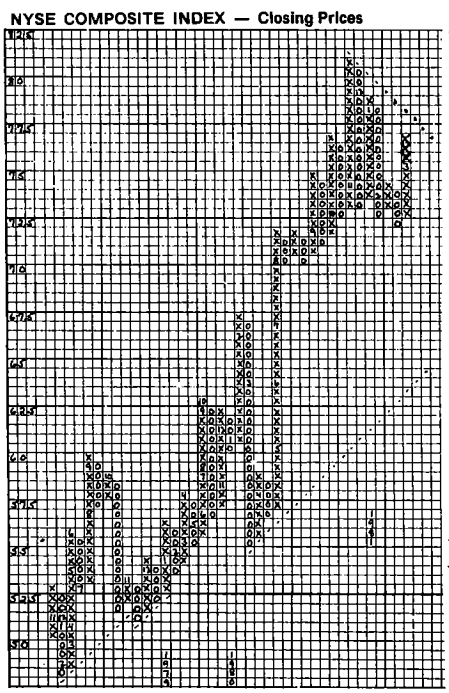
That means that for four months up to the present, the D-J Averages have been fluctuating in "no man's land," that territory under the previous highs but above the last lows. As I've said repeatedly, the downside points of significance in the Averages are 908.45 (Industrials) and 376.64 (Transports). On the upside the critical points are 1004.69 (Industrials) and 425.68 (Transports).

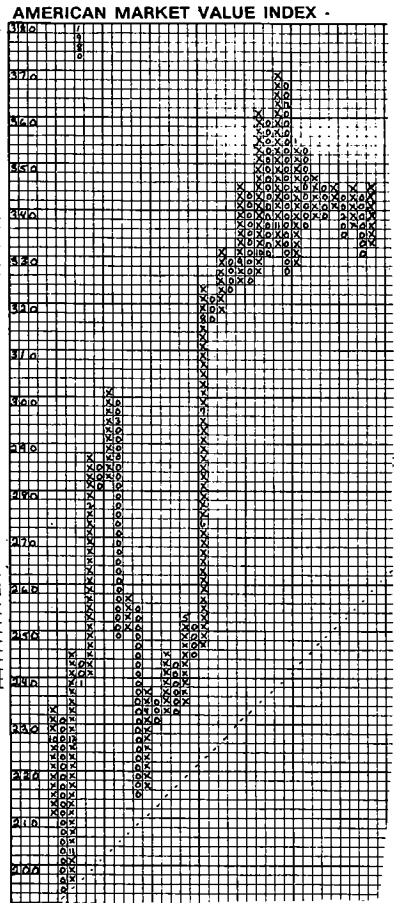
On March 16 the Transportation Average rallied above the 425.68 point, to a record high of 427.13, Industrials failed by 2 points to confirm. By March 19 Industrials had formed a little downward zig-zag while Transports backed off to the 416 level. It remains to be seen whether the action since March 16 is a pause, preparatory to a new attack on the highs – or whether the Industrial non-confirmation of March 16 contained a deeper (a more bearish) meaning.





During recent months the point & figure charts have traced out what could be tops in the various averages. These two charts (courtesy Chartcraft, Larchmont NY) illustrate my point. Now the appearance of a top can sometimes indicate nothing more than a consolidation, prior to a new advance. But in the majority of cases, the top pattern means just what it suggests – a top. And this is one of the reasons why I have remained somewhat cautious on the whole Wall Street picture.





As readers know, my Primary Trend Index has remained above its long rising trendline all during the formation of these potential tops. For this reason, although the top patterns bothered me, I stated over and over again that the trend "remained bullish."

One phenomenon which could very well be affecting this market is my oft-discussed 233-day cycle (chart top of Page 2). As seen on the accompanying chart, the market is now in cycle H (each cycle consumes a total of 233 days –144 bullish days and then 89 bearish days). The bull segment of current cycle H began in mid-December and is scheduled to carry into early May. During this time bullish cyclical forces will exert upward pressure on the market. In early May (give or take a week or so) the bear segment of cycle H takes over, and here the cyclical pressure will be on the downside.

Note that since 1976 all bullish cyclical segments but one (and that one occurred in 1977 during cycle C) resulted in higher prices. The bull segments of the cycles over the last 4 years have, therefore, been very reliable and very strong.

PRIMARY TREND INDEX: (Chart on page 3): I've always been careful about placing too much reliance (and money) on any single market indicator. And maybe that's why I'm drawn increasingly to trusting my PTI. The PTI is an amalgam of eight critical indicators and averages, and it seems that the weight of this daily mass of evidence is better than the reading of any single indicator or index.

The success (or should I say accuracy) of the PTI is not without its problems. And the problem is this: almost every day I receive a few Letters asking, "How can I keep the PTI myself, how can I construct it on my own?" And the answer, unfortunately, is that "You can't." The PTI is my own proprietary index, and it is the only "secret" I possess as far as the stock market is concerned. The reason I don't publish the actual composition of the PTI is that I'm afraid that if I did, shortly it would gather too large a following – and then, alas, the PTI would probably cease being the valuable tool that it now is. What everyone knows on Wall Street is never worth knowing. What everyone follows on Wall Street is never worth following. Whoever everyone follows on Wall Street is never worth following.

Question: Russell, I notice that on occasion you part company with your own PTI. That is, the PTI is bullish and you become cautious or advise staying mostly in T-bills. Why don't you get entirely in step with your own PTI?

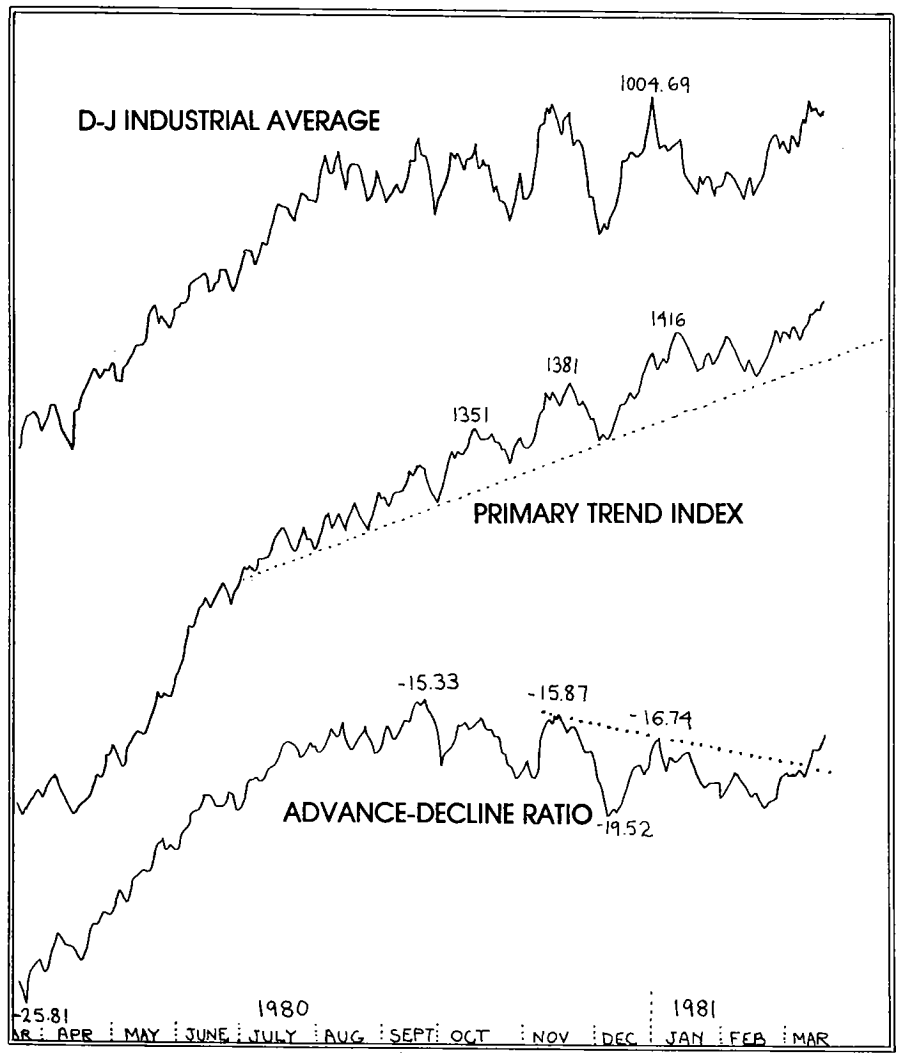
Answer: This Letter is written for intelligent, sophisticated investors. I include what I believe is valuable information and opinions in each report – and perhaps the PTI is the most valuable information I provide. Some subscribers and institutions now follow only the PTI and toss out the rest of the report. Others follow the position in the "Investment Box." Still others (probably a majority) make up their own minds, guided by the PTI and perhaps a dozen other factors. I'm not infallible, and moreover, I am probably prejudiced in favor of safety (after all, I've been handling my own investments since 1945). However, I see nothing wrong with a reader following the PTI to the letter – and staying invested in stocks as long as the PTI is bullish.

The recent story in the PTI is simple enough. On March 16 the PTI rose to a record high of 1430. The next day the Dow broke 10 points, but the PTI fell only 1 point. By March 20 the PTI had climbed to a new high of 1439. As I've said dozens of times

before, a PERSISTENT rising trend in the PTI will, in due time, take the market up with it.

INVESTMENT POSITION: The Dow Theory's last signal was bullish, and a trend is taken to remain in force until proved otherwise. The PTI continues to hit new highs. So trouble may be just around the corner, but you can't prove it with the Dow Theory or the PTI.

Subscribers should be in T-bills with alternative positions in no-load mutual funds. Mutual Shares, 170 B'way, NYC 10038 is a fund I like. I also like Dreyfus Number Nine (600 Madison Ave., NYC 10022). I think gold is a buy on any dip below 500 and ideally at 490-495 – see later section on gold. For my own part, being a conservative, I have the bulk of my funds in T-bills, and I want to remind subscribers that the bigger your position in any investment, the easier the shakeout. Thus, "reasonable" positions in gold or stocks often end with good profits while fat positions often end with losses and much sweat!



Question: How safe are the money market funds?

Answer: I am getting questions almost daily regarding the safety of money market funds, T-bills, bonds, bank deposit vaults, you name it. Obviously, people are VERY worried about their money and possessions these days.

Most of the money market funds (there are exceptions like Capital Preservation) are heavily invested in bank certificates of deposit. Thus, when you buy the average money market fund you are buying a diversified portfolio of bank C/D's. If there is a collapse in some "less-developed" nation and that nation drags billions of dollars in bank loans under with it, you could have a big bank scare. Or if a liquidity crisis develops, you could have a run on bank funds. Then there could at least be questions about whether a given bank would pay off immediately on its C/D's. This could affect the liquidity or conceivably even the solvency of a given money market fund.

My own preference is to place the bulk of my funds with T–bills, as these enjoy the full faith, credit and taxing power of the US Government. If a given bank gets into trouble, it is entirely possible that the Fed would come to its rescue, but this could take time and it could be messy. So I'm saying, "Why be 70% to 90% safe when you can be 99% safe in T-bills?

I've had people ask me whether I think the US Government is safe, whether the Government isn't actually as good a candidate for bankruptcy as the banks. My answer is that it's extremely unlikely that the US Government would ever declare bankruptcy, even if it was technically bankrupt. Which brings up the question of "How can the Government ever be bankrupt if it is able to create money?" The answer is that the Government could only be bankrupt if no one would accept that money. And of course, that possibility is the reason why many survivalists will never be without some kind of a position in real money – gold.

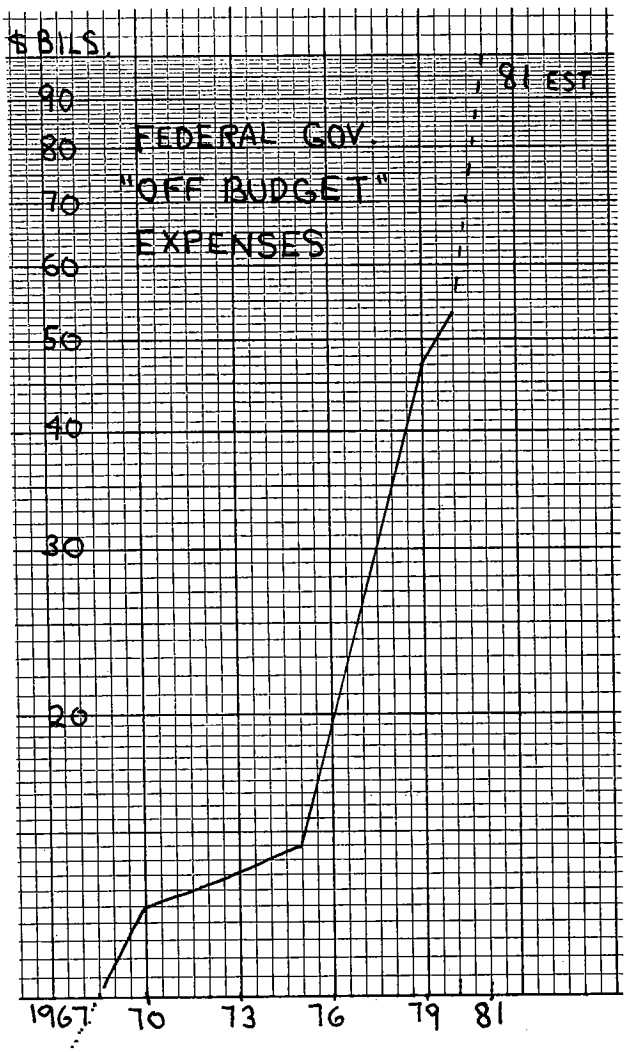
Question: Almost daily I receive survivalist literature in the mail. I am told to store dry food, buy guns, buy an escape cabin in the mountains, hide gold in my garden, learn self-defense, in short, I am told to prepare for anarchy. What do you think of all this?

Answer: The survival concept has become big business, but this doesn't automatically mean the concept is incorrect. I must say, however, that I am overwhelmed by the number of new newsletters with the word "survival" in their title.

At this point I'm taking a contrary opinion on chaos and the need for brute survival. I think too many people believe we are at or near a state of chaos, a situation in which it's "every family for itself." My own guess is that if the worst came to the worst, if say the banks collapsed or a run on the dollar occurred, at the first sign of real disorder the Government would declare a state of martial law. I could envision a temporary military government, but I do not see "blood in the streets" or a state of complete civilian and government breakdown.

But what if I am wrong? If I had to do one thing (and I haven't done this yet, although I've thought of it) I would buy a second house in a small town within an area I consider "safe." My choice of locations would be something like Utah, Oregon, Nevada in a town of around 10 to 20 thousand.

BUDGET HORROR STORY: I've stated many times that the least understood area of business is the finance area – and



more specifically that part of finance that has to do with the Federal Government. This is the reason why our bureaucracy has been able to get away with such "fiscal murder." The American people and most law makers simply do not understand finance, they do not understand statistics, and they do not understand compound interest.

Worse, most of the figures on US Government spending are not out in the open. A vast hidden source of Government spending is literally unknown. This is the strange and exotic world of "off budget" spending. This spending does NOT APPEAR in the official budget figures, but it does ultimately appear in the total of US Federal debt.

Most of the off budget spending is for US loan guarantees and for Federally sponsored lending (through agencies). It's done in the main through the Federal Financing Bank. The whole program really began to gather momentum in the period after 1978 and beyond the period of President Carter. The accompanying chart shows the rise of Federal off budget spending in the year since 1967.

What most people do not realize is that off-budget spending and Federally guaranteed loan spending (off-budget) is controlled only by Congress. And the job of cutting this off-budget spending down to manageable size (if indeed it can be cut) will be truly awesome. As it stands now, the agency spending is totally out-of-control.

In this fiscal year (1981) it is estimated that the total amount of new loans, loan guarantees and spending by both the Government and the agencies will be $129 billion, of which only $44 billion will appear on the on-budget account. Thus, spending that is not part of the regular Federal budget is careening off into space.

Another way of looking at it is simply total Federal credit outstanding (which includes direct Federal borrowing, Federal loan guarantees and loans by Federal agencies). In 1975 this total was $629 billion. In 1978 this total had jumped to $919 billion. The year 1979 saw $1.01 trillion, 1980 rose to $1.04 trillion and the estimate this year is $1.191 trillion. The total since 1975 has almost doubled, and the spending goes on at a furious rate.

The big immediate question: as massive financing needs hit the Government during the second half of this year, how will the Government act? Will they plunge into the money markets, or will they monetize the debt? My own guess is that the Government will do both. This will have the effect of running interest rates to (probable) new highs.

INTEREST RATES: As far as I'm concerned, the risk/reward in playing interest rates just isn't there. To put it mildly, the interest rate game is a total crap-shoot. The March 20 Wall Street Journal ran a front page article on "Cheaper Credit" and it is clear that the consensus is that rates are going lower. Yet many top Wall Streeters see higher (even record high) rates later this year.

I never like speculating in an area where too many eyes are focused. When this happens, markets become tricky and erratic. My own bet is the rates will move substantially higher by year's end, but I'm happy to average out the rates on 91-day T-bills. My own thought is this: people speculating on rate changes in 1981 will fare worse than people who are content to simply collect the average interest rates.

Near term, the Fed has been instrumental in bringing interest rates down, and my own feeling is that the Fed is very worried about the precarious position of the savings & loan institutions. Another few months of 16% short-term interest rates and we would have seen some S&L's go belly-up (you can't carry mortgages at 8 and 10% and pay 16% and more for short–term money). Meanwhile, the money market funds are draining the smaller banks while the big banks are selling the C/D's to the funds by the bucketfuls. The $102 billion in money market funds represents a potent, fast-moving mountain of "hot money."

NOTES & QUOTES: Greed is about to kill baseball. Of the 26 major league teams, only 11 showed a profit last year. From 1976 to present, salaries have risen from an average of $52, 000 to $150,000 in 1980. Salaries consume 35% of league revenues now, compared with only 22% in 1974. Overall, the teams now owe players more than $240 million in guaranteed salaries beyond this year. Item: the championship Philadelphia Phillies are up for sale. Item: the San Diego Padres lost $2.8 million in 1979 and 1980. Baseball owners are now looking ahead to their salvation – pay TV.

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The day Christ was born you start a business. The business is a disaster. You lose a million dollars a day. You continue to lose a million dollars a day right up to 1980. You continue to lose a million dollars a day for the next 700 years following 1980. At the end of that 700 years, you have finally lost a total of one trillion dollars. That's how much a trillion dollars is!

The Reagan plan is to spend $1.3 trillion on defense in the next 6 fiscal years. How do we finance it? How does the dollar survive it? I don't know. But I do know one thing. Chinese soldiers get $3.50 a month. Russian soldiers get $7.50 a month. But the US pays its head off fot its soldiers and sailors. About 70% of the US defense budget goes to salaries and pensions – the rest for hardware and arms. What the US really has is a mercenary army. We pay to keep 'em.

My own feeling is that this cannot go on. The US is going to have to go to the draft. It is also going to have to demand that its officers sign up for 20 years. What we've got now is a revolving door armed service. They come, they get trained, they leave. In one area it's become a joke. The Air Force is now known as the air line pilot's training school.

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Here's an interesting article that Marty Zweig brought to my attention. As you can see, they've put Dow Theory Letters in a high-level prediction catagory. Even so, there are three guys who are listed as smarter than yours truly. But that can't be – if they were so smart, how come they're not living in La Jolla (just kidding fellows, stay on the East Coast!).

Reprinted Courtesy: The New York Daily News, March 2, 1981

INFORMED SOURCES
By RICHARD STERN

DAILY NEWS

Investor newsletters: accurate as a coin flip

So you were looking for a way to beat the market and shelled out $100 to $275 for a year's subscription to one of those bigtime investment advice newsletters. Turns out you'd have been just as well off picking the right spot for your money by flipping a coin. At least with a coin the odds are 50-50. Investment newsletters, at least the 21 big ones on our chart, came up right only 48% of the time. The data come from **Mark Hulbert**, who is doing very nicely himself, thank you, by publishing Hulbert Financial Digest, a newsletter about financial newsletters. Hulbert's latest issue tracks the top 21 for the six months from June to December and turns up a 48% accuracy rate. For the first time, Hulbert has looked at how well the investment advice letters did predicting turns not only in the stock market, but also the economy, interest rates, precious metals and other areas. The Zweig forecast got the highest over-all average because it was right on the stock market 10 out of the 11 times it made a forecast. The worst record was compiled by **Howard Ruff** of Ruff Times, which on average was right only 12% of the time. The reason: His regular predictions that gold would hit $850 to $950 by the end of 1980. As you can see, the famous **Joe Granville** was right 10 out of 18 times on market turns, but wrong the one time he predicted interest rates. Hulbert admits there are imperfections in his tracking method. For accuracy's sake, he counted only predictions for a given time period. So, for instance, he ignored **Jim Dines'** declaration in his June 1980 newsletter that if the Dow Jones Industrial Average didn't fall below 570.01 he'd stop publishing his newsletter. Similarly, he didn't count guru Granville's prediction of an earthquake in California April 10.

INVESTMENT NEWSLETTERS: Their Prediction Record

	Stock Market	Economy	Interest Rates	Precious Metals	Other	Correct
Zweig Forecast	10/11		0/3			71%
Professional Tape Reader	8/12		1/1			69%
Elliott Wave Theorist	3/5		1/2	2/2		67%
Dow Theory Letters	1/2	2/3	6/8	4/7	2/3	66%
Dow Theory Forecasts	5/6		1/2		1/3	64%
The Dines Letter	0/2		3/4	2/3	3/4	61%
Professional Investor	5/7		3/5		0/2	57%
Wellington Financial Letter	3/8	2/2	7/11	2/4	1/2	56%
United Investment Report	3/3	6/10	3/7		0/2	55%
Granville Market Letter	10/18		0/1			53%
International Moneyline	6/7	4/14	5/11	2/3	5/7	52%
Greens Commodity Comments	1/1	0/1	2/2	5/12	50%	
Harry Browne's Special Reports	0/1	1/1	1/2			50%
Heim Investment Letter	1/9	0/3	5/6	5/7	0/2	41%
Myer's Finance & Energy	0/1		1/3	3/6	1/3	39%
Outlook	3/6	2/9	3/7		1/3	36%
International Schultz Letter	0/1		0/3	1/1	1/1	33%
Holt Investment Advisory	2/15	1/2	6/8	0/1	0/2	32%
Sinclair Securities	1/1	1/1	3/5	2/17	3/7	32%
World Market Perspective		0/1	1/3	1/4		25%
Ruff Times			0/3	1/11	1/2	12%
TOTALS	54%	40%	54%	38%	44%	48%

* *

Sometimes you have to read the overseas publications to find out what's happening in the US. For instance, have you wondered why the Utility Average is lagging. This story from a recent issue of the London Economist tells the story:

> America's electricity generating industry is in such deep financial trouble that it will provide the Reagan administration with its biggest industrial problem, dwarfing the troubles of steel and cars. The electricity utilities are squeezed by soaring construction costs, record interest rates, sluggish (and controlled) revenues, long delays to most building projects because of environmentalists' objections. If the squeeze continues, parts of the country could be short of electric power by the end of the decade. Some utilities could go broke, heralding the end of America's mostly private electricity industry and thwarting President Ronald Reagan's free-market mission.
>
> The industry cannot afford to build the new power stations the country needs: its building programme is projected to cost $150 billion between 1980 and 1984, with investment worth a further $250 billion needed by 1990. Revenue growth has slumped with slackening demand: from 8% annual growth in kilowatt sales in the late 1960s to just under 5% in the past five years, and an expected 4% for the next five. They face long-term borrowing at 14-15%, when the return on equity averages about 10.5%. Overruns in construction costs and construction times make a farce of financial planning, with ever-changing federal regulations in the wake of Three Mile Island adding to the inflation. One nuclear plant in Michigan, originally budgeted at $350m, will now cost over $3 billion.

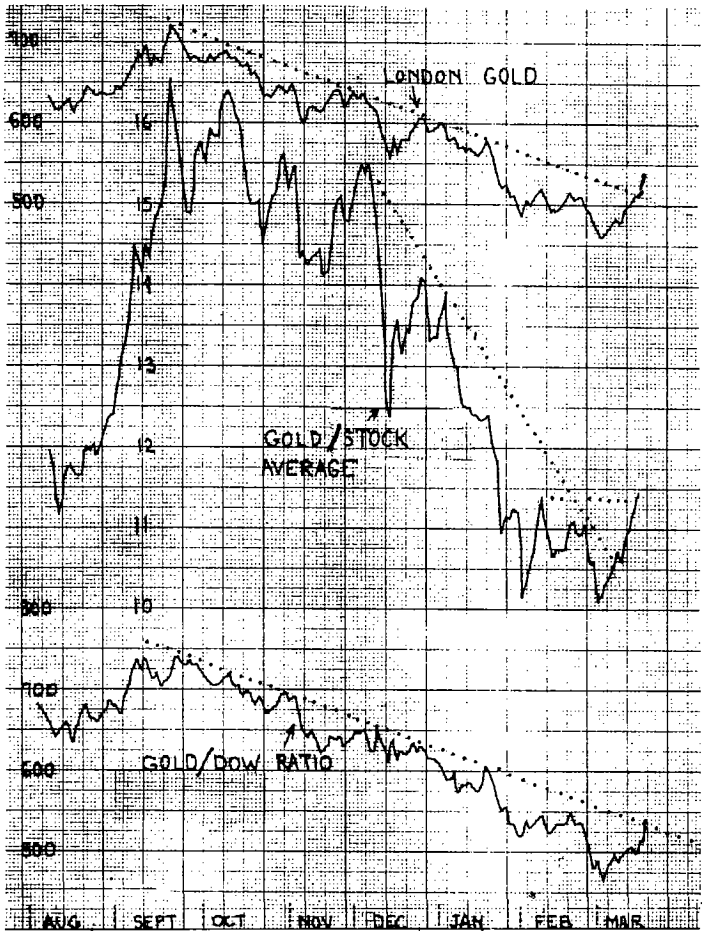
* *

I spoke yesterday (March 19) a Howard Ruff's little San Diego semi nar. There were 5,000 in attendance – from all parts of the nation. I allowec about 10 minutes after my speech fo questions and answers, and someone asked me about the proposed nev San Diego Convention Center. Here's what I told him, "It's a great idea whose time has come – and passed. I was originally costed out (1974) a $67 million. The price is now $22 million and rising at the rate of $1 tc $1.5 million a month! At this point I concluded, "I think it's a baaac idea!"

Howard always gives me (blush) very flattering introductions, and I only wish I could live up to them. By the way, if Howard isn't Governor o Senator of Utah within a few years one market letter writer will be surprised.

GOLD: Today, everyone hates gold, everyone is bearish on gold The WSJ (March 19) carried an article about the former gold bulls, and alas, only Jim Dines is left in the bull camp. I've beer hearing and reading nothing but "downside counts" and projec tions for gold. "It's going to 350," "No, it's going to 290." The chic thing to do of late is to be short gold. Note the new shor position in Homestake, a jump from 182,000 to 250,000!

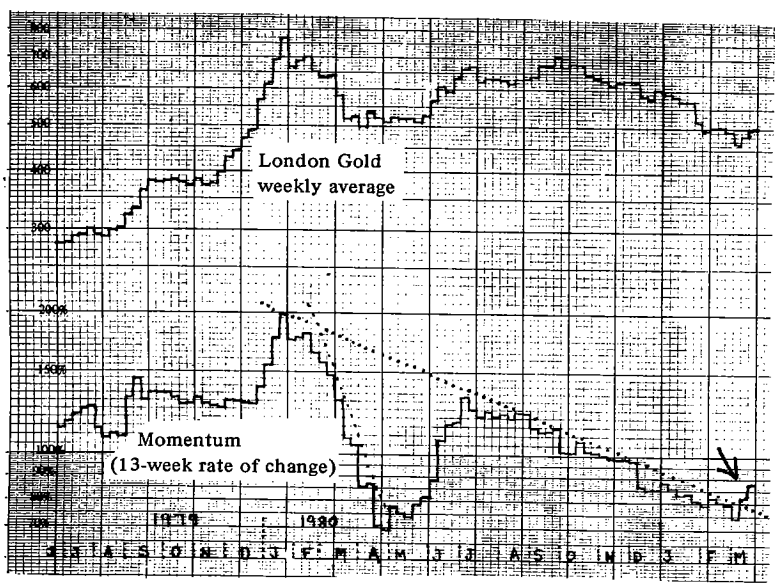
My own feeling is that the 457 low of March 5 is going to be the low for quite a while. Last week my gold momentum chart (13



week rate of change) turned bullish – for the first time since the 1980 high (see chart). On my daily chart gold moved out of the upper trendline; it did this when it moved above 505.

I show here a chart of daily gold (one posting a day), my gold stock average (which is actually International Investors, a gold fund) and the daily ratio of gold to the Dow. All three are looking promising.

Most interesting is the possibility of a large "head-and-shoulers" bottom in gold. In order to complete an ideal bottom, gold would have to back off again – preferably to the 485-495 area, then rally above 520.



Advice: I think gold is an interesting buy on any decline below 500-495. Even a one third correction of the drop from 720 to 457 would take the metal back to 544. A 50% correction would take gold to 588.

Note: momentum usually turns up *before* price. For this reason, I take the reversal of the long, downtrend in gold's momentum (together with today's bearish sentiment towards gold) as hopeful harbinger for the metal.

LATE NOTES: Many of my volume studies are now turning decidedly bullish; negative volume and cummulative volume are giving off bullish signals for the stock market. The PTI closed the week out (week ending March 20) at a record high of 1439! The fact is that the PTI goes down very grudgingly on declining market days – but it goes up strongly on rally days. The interpretation is that down days are selective, up days show broad strength. If the Industrials break out above 1004.69 together with the major composite Averages, I would expect a running of the shorts. That could give us a high volume spike at least into May. I wouldn't want to be short in that event – you better believe me! (Note the 6% jump in the short interest this month).

Those playing this market are (from what I've seen) putting entirely too much energy and time into selection. The no-load mutual funds will give you all the participation you need in this market. Why sweat out 10 or 15 stocks when a fund manager can do it for you. It's enough that we sweat out direction – but even there the PTI is doing most of the work for us.

The New Yorker's cartoons often capture the humorous soul of the nation, and I think this one is on the mark.

"You heard the President. We're in this together."

NEXT MAILING: April 8